Keywords: **blocking patent, commercial viability, patent misuse, price fixing, tying agreement**

General: **A blocking patent is one that at the time of the license, an objective manufacturer would reasonably believe might be necessary to the practice the technology at issue. Horizontal competitors cannot insulate themselves from misuse liability simply by agreeing to suppress competing technologies before they are fully developed.**

Princo Corp. v. International Trade Commission
90 U.S.P.Q.2d 1673 (Fed. Cir. 2009)
Decided April 20, 2009

I. Facts

In the late 1980's and early 1990's, Philips and Sony jointly developed the "Orange Book," a technical standard ensuring compliance of CD-R and CD-RW discs with CD players and CD-ROM drives that have also been manufactured to the standard. In the early 1990's, Philips, Sony, Taiyo Yuden, and Ricoh agreed to pool their Orange Book-related patents. Philips would administer the pool and the other companies would receive a share of the royalties. Philips offered a joint license to the pooled CD-R patents and a joint license to the pooled CD-RW patents and did not offer licenses to individual patents. The licenses required a per-disc royalty on each disc produced using at least one licensed patent. The royalty was a set amount and did not vary depending on how many of the patents in the pool were actually used.

While developing the Orange Book standard, a need arose to encode position data on discs using the existing wobbled pregroove, and doing so in a manner backwards-compatible with existing CD players. Philips developed an analog approach known as "Absolute Time in Pregroove" or "ATIP," covered by Philips's U.S. Patent Nos. 4,999,825 and 5,023,856 (hereinafter, the "Raaymakers patents"). Sony developed a digital approach covered by Sony's U.S. Patent No. 4,942,565 (hereinafter, the "Lagadec patent"). Although the two methods solve the same basic problem, they are fundamentally incompatible with each other (i.e., not interchangeable). The Orange Book standard ultimately used the analog Raaymakers ATIP approach.

Philips brought suit against companies for infringement of patents within the pool. Princo was not one of the respondents, but moved to intervene and asserted a patent misuse defense. The ITC found for Princo on very narrow grounds and Philips appealed. On appeal, the Federal Circuit reversed and remanded back to the ITC for further consideration of Princo's remaining arguments.

On remand, Princo claimed, among other things, patent misuse regarding the Lagadec patent. Under a tying theory, Princo alleged the Lagadec patent was nonessential to the production of Orange Book compliant discs and was unlawfully tied to essential patents. Under a price-fixing theory, Princo alleged both the Lagadec and Raaymakers patents covered potentially competing technologies and Philips and Sony agreeing to only make the patents available as a package foreclosed any potential competition between the technologies and was thus a form of price-fixing. The ITC found for Philips and said no patent misuse occurred. Princo appealed with regards to these Lagadec arguments.

Patent misuse is an equitable defense designed to restrain practices that did not in themselves violate any law, but that drew anticompetitive strength from the patent right, and thus were deemed to be contrary to public policy. The key inquiry in determining whether a patentee's conduct constitutes misuse is whether, by imposing conditions that derive their force from the patent, the patentee has impermissibly broadened the scope of the patent grant with anticompetitive effect. Some practices, such as when a patentee having market power conditions a license upon the purchase of a separate, staple good, are sufficiently anticompetitive so as to warrant condemnation on their face. These constitute patent misuse per se. Other allegedlyanticompetitive practices are evaluated under the rule of reason to determine whether they impose an unreasonable restraint on competition.

II. Issues

A. Did the ITC err in finding the Lagadec tying claim to be improper?

B. Did the ITC err in finding that Philips and Sony did not engage in price fixing?

C. Was there an agreement between Philips and Sony to prevent the licensing of Lagadec as a competitor to the Orange Book?

III. Discussion

A. No. On appeal, the court found that claim 6 of the Lagadec patent made it essential as a blocking patent and thus not improperly tied. It is noted that, the Federal Circuit affirmed the ruling on new grounds (choosing not to analyze the ITC's decision).

The court stated that the inclusion of essential patents in a package license to enable the practice of particular technology by clearing blocking positions is not the type of tying the patent misuse doctrine seeks to prevent. A blocking patent is one that *at the time of the license*, an objective manufacturer would *reasonably believe* might be necessary to the practice the technology at issue. "Prohibiting the inclusion in a package license of a patent that is arguably essential, merely because it ultimately proved not to be essential would undercut, even eliminate, [] potential precompetitive efficiency," such as reduced transaction costs, reduced litigation expenses, and a reduction in the degree of uncertainty associated with investment decisions. The court analogized the practice to that of standards-setting organizations, where disclosure of not only blocking patents is required, but also those that reasonably might be necessary to practice the standard.

Claim 6 recited, *inter alia*, "a disc-shaped recording medium . . . having formed thereon a substantially spiral pregroove which is wobbled . . . and formed by . . . a first signal . . . that has been modulated by a second signal . . . ." Lagadec patent, col. 10, lines 14-24.

Princo argued that the claim must be read in light of the specification, which discloses primarily a digital encoding scheme, and thus teaches away from analog methods. Philips acknowledged that the Lagadec patent generally teaches a digital method of encoding position data not used by the Orange Book, but argues that the specification cannot be used to read a digital limitation into the claim where such a limitation is absent from the language of the claim.

The court stated that the language of the claim would have made a manufacturer reasonably believe the patent to be essential as a blocking patent to the Orange Book standard at the time of licensing. No prosecution history was brought up that limited the scope of the claim and the law of claim construction was still unsettled when the licenses were executed, so a manufacturer would have been taking a gamble in reading the specification as a limitation on the claims. Thus, legitimate questions as to the scope of the patent existed at the time.

B. Yes. The court found that all of the ITC's grounds for rejection were not adequate and remanded for further proceedings.

The ITC stated that if the Lagadec patent is technically a blocking patent, then no misuse flows from including the patent in joint licenses. The conclusion stemmed from the Federal Circuit's statement in the first appeal that a patentee holding blocking patents may "lawfully insist on licensing the patents as a package and may refuse to license them individually, since the group of patents could not reasonably be viewed as distinct products."

The court stated that in the first appeal, they had not considered whether an agreement preventing the development of alternatives would constitute misuse under a theory of elimination of competition or price fixing. The statement simply held that package licensing of blocking patents is not patent misuse as a form of tying. Additionally, the court had held a patent cannot be deemed nonessential due to supposed alternatives if the claimed alternative is not commercially viable. Agreements between patent holders to forego separate licensing of competing technologies do not provide the same benefits of tying arrangements, and such agreements would constitute classic antitrust violations.

The ITC stated that there had been no showing that Philips and Sony would have competed in the technology licensing market absent the pooling arrangement. The conclusion stemmed from the ITC analogizing the licensing arrangement to a merger in which case harm would be found only if it was shown that Sony would probably have entered the market within a reasonable period of time and would have become a significant competitive force.

The court stated that the merger analogy is not accurate though. Unlike the alleged agreement not to compete in the instant case, a merger of two companies has potential countervailing efficiencies that offset potential harms to future competition (e.g., socially desirable resource savings through improved economies of scale). Any potential efficiencies achieved through the alleged agreement could most likely be achieved through non-exclusive agreements as well (that would leave open the possibility that the technology taught by the Lagadec patent would still be developed).

The ITC stated that even if Lagadec is a substitute technology for the ATIP standard taught by the Raaymakers patents, it is not a substitute that can be used to manufacture Orange Book discs.

The court found that while the statement is supported by substantial evidence, it is irrelevant to the argument (Princo argued that the Lagadec patent was an alternative that was not allowed to be utilized, thus harming competition). Philips argued there was no showing that the Lagadec patent was commercially viable, meaning it could not be an alternative competitor. The court stated however that horizontal competitors cannot insulate themselves from misuse liability simply by agreeing to suppress competing technologies before they are fully developed.

The court listed four considerations to take into account under the rule of reason.

- The fact that a patent's disclosed embodiments may not be commercially viable cannot be dispositive. Time may be needed to reach commercial viability.
- It may be difficult to show that the patented technology would or would not be commercially viable in the absence of market incentives to commercialize the technology.
- Even a faulty technology may provide some meaningful competition.
- There are no benefits to be achieved from suppression of potentially competing technology, suggesting that there would be no harm to competition from adopting a protective rule.

The court left the decision on where on the continuum the instant case lies to remand (i.e., the spectrum from certainly viable to not remotely viable).

C. Potentially. The court stated the ITC must determine whether or not there is sufficient evidence to justify that an agreement existed on remand. The burden of proving misuse, and the corresponding risk of having made an insufficient record, lies with Princo however. The court notes three considerations the ITC should take into account though.

First, it was undisputed that the Orange Book joint licenses that included Lagadec only permitted the use of the Lagadec license to produce Orange Book compliant discs (i.e., did not allow its use in a competing standard).

Second, there was evidence that could support a finding that Sony granted Philips an exclusive license to Lagadec for CD-R purposes in a 1993 agreement, and that Philips agreed not to license the patent (absent “exceptional” circumstances) except for the manufacture of Orange Book compliant discs.

Third, there was evidence that if the 1993 agreement did apply to Lagadec, Sony may have agreed with Philips not to license the Lagadec patent for non-Orange Book purposes.

The ITC would need to determine the weight of such evidence on remand.

IV. <u>Conclusion</u>

The Federal Circuit affirmed the ITC’s judgment of no patent misuse with regards to unlawful tying and remanded for further proceedings with regards to the allegations of price fixing.